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SUBJECT: KAZAKHSTANI BANKS: ADJUSTING TO A CHANGING LANDSCAPE

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REFTEL: ASTANA 2200

11. (U) Sensitive but unclassified. Not for public Internet.

12. (SBU) SUMMARY: Financial analysts, bank executives, managers, and customers alike agree that the Kazakhstani government's efforts to restructure debt and successfully keep afloat ailing BTA and Alliance banks are critical to the overall recovery of the financial sector. A failure of both these institutions would not only translate into the loss of billions of dollars of Kazakhstani taxpayer funds, but could also result in a loss of foreign-investor and local confidence in the country's financial system. In the wake of new government regulations intended to strengthen the banking sector, banks in Kazakhstan must adapt, or disappear. Because of the narrow banking-customer base, overall tightness of financial markets worldwide, and marginal quality of existing bank assets, foreign sources of capital will remain important despite the government's efforts to limit access to relatively cheap foreign cash. While ample evidence for continued pessimism remains, many perceive opportunity and growth over the horizon, as long as the restructuring of BTA and Alliance banks are seen as a success. END SUMMARY

THE CHANGING LANDSCAPE

13. (SBU) On the eve of Kazakhstani Independence Day (December 15), Chairman of the Kazakhstan Association of Financial Institutions, which represents 238 local and foreign banking institutions, Serik Akhanov termed this period critical for the local banking sector. He recounted President Nazarbayev's November 16 meeting with bank leaders, which outlined the government's strategy to address concerns over transparency and portfolio risk. The four-point strategy, according to Akhanov, will implement new regulations to mandate minimum-liquidity ratios, invest billions in low-interest loans to provide an alternative source of funds for banks and businesses, establish standards for better qualified bank management, and continue to restructure large, defaulted banks.

14. (SBU) While he admitted that the picture is not pretty, Akhanov adamantly asserted that the Kazakhstani public remains confident in the banking system. To illustrate his point, he pointed to the 23% increase in bank deposits in 2009, due in part to the National Bank's new guarantee of up to 5 million tenge (approximately \$338,000) per deposit. Separately, ATF bank branch manager Aderna Nurtaeva told EmbOff about her bank's 78% increase in deposits -- equivalent to an additional \$1 million -- over the past year. However, she qualified her statement by explaining that these one-year-term deposits are usually under \$1,000. Nurtaeva claimed the lucrative flood of deposits resulted from the new deposit-guarantee rules and ATF's reputation as a large, foreign bank with 154 branches located throughout the country. Although deposits significantly increased, she admitted that loan activity has ground to a halt despite the bank's "attractive" loan program offering 21-35% mortgage rates, depending on income and risk.

15. (SBU) Assuming a more somber tone, Akhanov asserted structural obstacles in the Kazakhstani economy could threaten the government's plans. He claimed that many people continue to hold dollars "under the bed" as a possible hedge against devaluation and inflation, and highlighted the growing rate of unemployment, which officially is at just under 7% but may be twice this number, including underemployed. He asserted that this situation further curbs any appetite to invest, let alone spend. (NOTE: The same day, Prime Minister Masimov claimed a falling unemployment rate of 6.3% (reftel). END NOTE.)

16. (SBU) On December 14, Deputy Akim of Almaty Marat Kudyshev -- and city budget chief -- pointed to rising unemployment as his main concern. Now at historic levels, he said unemployment threatens the general mood of consumer confidence and undermines his ability to

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raise city funds. A recent survey of employers published by "Focus," a business daily, showed that two-thirds of employers plan to cut or curtail salary expenses through lay-offs or salary cuts. In separate meetings with EmbOff, KZ Rating Deputy Director Denis Rybalkin echoed these same concerns and lamented that the National Bank's recent decision to leave interest rates unchanged will not improve the investment climate because of uncertainty over jobs. He asserted that people are not spending and jobs are not being created, despite the apparent stabilization of inflation. Therefore, he argued for a stimulus in the form of lower interest rates.

COMPETITION IN A NARROW MARKET

17. (SBU) Separately, both Akhanov and Rybalkin claimed that the government's proposed policy to mandate at least \$33 million in bank equity (5 billion tenge) is intended to encourage bank mergers and an overall "thinning" of the banking community. KZ Rating's analysis suggested that many non-performing banks might be forced to leave the market because of their higher percentage of non-performing assets (i.e., loans, investments). Akhanov also argued that current consumer demand does not support the existing number of banks. He argued that Kazakhstan's relatively small, dispersed population translates into a wage-earning population of less than 5 million, which generally has little discretionary money to save or invest given GDP per capita of under \$5,000. (NOTE: According to the official statistics, 7.9 million people earn wages in Kazakhstan. END NOTE.) For example, 28-year old taxi driver Abay Okeu complained to EmbOff that he has no disposable income left after he pays for rent, food, clothes, and gas.

18. (SBU) Nurtaeva also expressed concern about bank competition and market over-saturation. Located in the NurliTau Business Center amidst one of the more upscale neighborhoods in Almaty, Nurtaeva competes with nine other bank branches in the building, making it hard for individual banks to stand out to potential customers. She also complained about significant expenditures on training programs and supervision because the monthly salary of 45,000 tenge (\$300) is insufficient to attract qualified cashiers. KZ Rating's Rybalkin asserted that the government recognizes the problem of bank over-saturation in certain market areas and under-representation in

others. He mentioned discussion of bank "regionalization," concentrating activities in specific areas, due to the decision by many banks to work only in big cities.

FOREIGN BANKS -- CHANGE OR DIE

¶9. (SBU) In separate meetings with Emboff on December 15, HSBC and RBS (Royal Bank of Scotland) Chief Executive Officers Simen Munter and Rudi Geerdink acknowledged the necessity of successful government intervention in the wake of the payment defaults. Munter told Emboff that while "one man's bust may be another's gain," he loathes seeing any banks fail because of the overall impact on confidence. Despite problems in the banking industry, Geerdink more bluntly declared the necessity due to the absence of any other obvious investment or money-holding options in the country. While Munter viewed the long-term prospects of many local banks with a large degree of skepticism because of the banking system's rigid nature and lack of transparency, Geerdink remained cautiously optimistic about the government's bank takeovers. Both men argued, using very different approaches, that foreign banks -- while comparatively small -- serve an important function, offering top services not available through domestic banks, such as RBS' on-line bill-pay services.

¶10. (SBU) Unlike HSBC, RBS, Geerdink said, chose not to offer mortgages due to the unsound price point in the real estate market. Munter, however, argued for HSBC's focus on mortgage business, because he views these customers as long-term business partners provide selective, risk-averse underwriting. He claimed that HSBC

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now offers the most competitive rates in the country, averaging 11.5-15% (retail rates average just above 15% now according to KZ Rating).

¶11. (SBU) Despite its absence from the mortgage market and lower deposit interest rates, Geerdink asserted RBS continues to increase its market share. He attributed RBS' success to strategic planning and the absence of alternatives because of local banks' "poor service and outrageous fees." Geerdink viewed only Halyk bank as having a legitimate, long-term future. While he was upbeat about RBS compared to its competition, Geerdink criticized the National Bank's decision to limit non-Kazakhstani deposits in banks to 50%.

¶12. (SBU) According to Geerdink, higher oil prices and the tenge's creeping value against the dollar (148 up from a high of 152) have caused many of his customers to switch from dollar to tenge deposits. In recent months, he observed a reversal of the 30/70 split between tenge and dollar deposits last year to a 70/30 split today. He noted the large cash holdings of all major foreign banks due to flat-lined lending coupled with increased retail and corporate deposits. Because this trend extends beyond Kazakhstan, Geerdink believes foreign banks will act as a source of borrowing for other domestic banks.

¶13. (SBU) COMMENT: The effect of new banking regulations designed to address weaknesses in Kazakhstan's banking regime remains unclear. Proposed measures to regionalize banks and require minimum thresholds for bank equity might not have the intended outcome on competitiveness nor result in better services/access to the public. In the end, market forces on oil prices could have a bigger impact on the direction and speed of the banking sector's recovery than any government regulation. END COMMENT.

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